imc
financial markets

August 15, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 29549-1090

Re: SEC Release No. 34-64981; File No. SR-BX-2011-046

Dear Ms. Murphy,

IMC Chicago, LLC d/b/a IMC Financial Markets ("IMC")[1] appreciates the opportunity to submit this comment letter in response to the recent filing by NASDAQ OMX BX, Inc. proposing to amend the Fee Schedule of the Boston Options Exchange Group, LLC ("BOX"). For the reasons set forth below, IMC requests that the Securities & Exchange Commission ("Commission") suspend the effectiveness of the BOX fee filing.

Currently, the BOX Fee Schedule specifies a $0.30 credit (for initiators) and a $0.30 fee (for responders) for transactions conducted in the BOX Price Improvement Period ("PIP"). According to the filing, the BOX intends to raise the credit and the fee for PIP transactions in Non-Penny Pilot classes and Penny Pilot Classes (other than QQQQ, SPY, and IWM) where the trade price is equal to or greater than $3.00, from $0.30 to $0.75 per contract. These fees and credits are assessed in addition to any other applicable trading fees set forth in the Fee Schedule. Although IMC believes that market forces should typically be permitted to dictate the levels and acceptable limits on pricing mechanisms, exchanges are not permitted to impose unduly burdensome and unreasonably discriminatory fees. IMC believes that this fee structure—

[1] IMC is a proprietary trading firm and registered broker-dealer, engaged in providing liquidity in nearly every listed equities and derivatives market in the U.S. In addition, IMC is part of a global firm with affiliates trading in Amsterdam, Zug, Sydney, and Hong Kong. IMC is a registered market maker in U.S. exchange listed products. As a market maker, IMC establishes two-sided markets which serve to aid investors in their effort to mitigate or transfer risk.

regardless of the level of the fee[2]—is an undue burden on competition and unreasonably discriminates amongst participants. As a result, the proposed PIP transaction fees fail to satisfy the statutory requirements of Sections 6(b)(4), 6(b)(5) and 6(b)(8) of the Securities Exchange Act of 1934 ("Exchange Act").

Discussion

A. The Proposed Fee Increase Imposes an Undue Burden on Competition

According to the BOX, the proposed increase is designed to provide an additional incentive to all BOX participants to submit their customer orders to the PIP and allow those orders the opportunity to benefit from its potential price improvement. The BOX also suggests that the credits and fees apply equally to all account types and that limiting the increased rates only to the specified classes and transactions is fair and reasonable because such options trade at minimum increments of $0.05 and $0.10, thereby providing greater opportunity for market participants to offer additional price improvement. These arguments don't ring true.

The PIP is designed as a means for a broker-dealer to provide its customer with price improvement by at least one cent above BOX's current bid or offer. To foster meaningful opportunities for price improvement, the PIP initiator must expose the order to other interested participants who in-turn may respond and compete for the order. Naturally, the greater the amount of competition, the greater likelihood of meaningful price improvement and the inevitability that the initiator will see his customer's order "broken up" amongst participants. Of course, where the initiator also trades against the order, the PIP fees and rebates will net out to zero cost, whether at their current or proposed levels. According to the BOX Fee Schedule, the total transaction cost to the initiator, therefore, amounts to a sliding scale of anywhere from $0.10 to $0.25 per contract, depending on certain volume thresholds.

In contrast, the fee differential applicable to other market participants is dramatic. All other non-initiating (competing) responders to the PIP broadcast, for example, in exchange for providing liquidity, will be assessed the increased $0.75 fee. The total cost to the non-initiating responder, when factoring in the applicable $0.25 charge per contract, rises to $1.00 per contract. The prospect of this dramatically increased burden applies solely to PIP responders (in favor of PIP auction initiators) and will deter anyone other than the initiator from providing liquidity via the PIP. In the absence of any compelling justification, the BOX has thus erected an unreasonable barrier to participation, effectively barring certain participants from competing with PIP initiators.

B. The Proposed Rate is Inequitable and Unfairly Discriminatory in both Design and Impact

[2] Indeed, raising the fee from $0.30 to $0.75 exacerbates the existing discriminatory and anticompetitive impact of the current PIP pricing structure.

Unfortunately, the unreasonable burden of the proposed fee increase further aggravates a pricing structure that already inappropriately favors PIP initiators at the expense of PIP responders—without providing any material benefit to customers. In other words, by discouraging participation and competition, the BOX greatly enhances the ability of PIP initiators to fully internalize their customer's order. In this regard, IMC notes the test results of Citadel LLC. At the time the BOX first introduced its PIP fee structure (at the then fee of $0.25), Citadel reported that it tested new functionality for routing orders to the PIP as the initiator and found that in options with a quoted spread of $.01 it internalized approximately 92% of the orders at the national best bid or offer ("NBBO").[3] The message is clear: anticompetitive and discriminatory pricing structures reduce competition and increase internalization, resulting in significantly reduced opportunities for meaningful price improvement. The proposed fee increase will only intensify these results.

Despite these obvious concerns, the BOX fails to explain how the increased rates and the dramatic discrepancy between the costs to PIP initiators and competitive responders are anything but unreasonable and discriminatory. Claims that participants may send their orders to other exchanges or that the fees collected will not result in any additional revenue to the BOX, do not mollify or address our concerns regarding the excessively high barriers to access that these proposed costs raise.

C. Special Rebates or Fees Should Be Eliminated in the PIP or Similar Auctions

IMC respectfully urges the Commission to eliminate payment-for-order-flow or rebate/fee structures—regardless of the rate—that penalize liquidity providers participating in the PIP or similar auctions offered by other exchanges. These payment structures pose undue burdens on competition by actively discriminating against auction responders in favor of auction initiators. As a result, participants, if they are not altogether discouraged from participating, typically join the PIP process less often and less aggressively when they do respond. Auction initiators, on the other hand, benefit from greater opportunities to internalize their select order flow—to the detriment of customers and the quality of the markets. Customers, whose orders trigger these "price improving mechanisms" and who should be the ultimate recipient of any benefit, suffer from wider spreads and reduced transparency in the absence of competition and meaningful quoting obligations.[4] In light of the renewed and appropriate focus on the importance of quoting on lit markets, we find the prospect of increased internalization troubling.[5] We request that the

[3] *See* Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission, from John C. Nagel, Managing Director and General Counsel, Citadel LLC, dated August 30, 2010.

[4] Currently, the BOX does not require the initiating participant to be present at the NBBO in order to receive the typical minimum 40% allocation under PIP rules. In the absence of such a requirement, market participants with significant customer order flow are able to quote wide, with little to no risk of order interaction, but then use the price improving auction period to offer a "tighter" price and trade with its preferred customer order flow.

[5] The Box is not alone in offering a "price improving mechanism" that serves mainly as an internalization mechanism in the absence of meaningful quoting obligations. The CBOE's "AIM", the PHLX's "PIXL" and the

Commission review the competitive impact of these price improving mechanisms for fairness and compliance with the applicable regulatory standards.

Conclusion

IMC believes that market forces should typically be permitted to dictate exchange pricing mechanisms. However, when exchange fees are unduly burdensome upon competition and unreasonably discriminate amongst participants, the Commission must intervene in order to maintain a dynamic and equitable marketplace. The BOX PIP fees, in both their design and impact, fail the applicable standards set forth in Sections 6(b)(4), 6(b)(5) and 6(b)(8) of the Exchange Act. As a result, and for the reasons described herein, the BOX PIP fees should be suspended.

IMC appreciates the opportunity to comment on this proposal. Should you have any questions in connection with our comments, please feel free to contact me at 312-244-3355.

Sincerely,

Andrew Stevens
Legal Counsel

cc:

Robert W. Cook, Division of Trading and Markets
James A. Brigagliano, Division of Trading and Markets
Heather Seidel, Division of Trading and Markets

ISE's "PIM" similarly fail to require directed order flow recipients to be present at the NBBO in order to be eligible to receive up to 40% of the incoming order via their respective auction mechanisms.